SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

Securities Industry Association
120 Broadway
New York, New York 10271

Phone (212) 608-1500

Annual Subscription
$30.00 member • $48.00 non-member
$60.00 subscribers outside U.S. and Canada

Vol. XII, No. 6 November 8, 1989

Here Now. Gone Tomorrow?

A strong 2Q89 U.S. equity market, propelled by M&A activity and a stable greenback, led to foreign net purchases of $4.5 billion of U.S. stocks, up more than ten-fold from the first quarter's $389 million. The increase in net purchases was accompanied by a 17.5% increase in gross transactions; from $91.8 billion in the 1Q to $107.9 billion in the 2Q.

U.S. investors exhibited similar behavior, making record 2Q net purchases of over $4.4 billion of foreign equities and increasing gross activity 2.2% to $51.6 billion. Of this, U.S. investors committed a record $3.3 billion to the U.K. market, which, despite numerous interest rate increases and a 14% base rate, somehow increased nearly 19% during the 1H89.

In terms of first half comparisons, foreign activity in the U.S. equity market was considerably brighter than the same period last year. During the 1H88, for instance, foreign investors totalled gross transactions of $192.1 billion and net sales of $168 million. First half 1989 totals show a slight 4% increase in gross activity, to $199 billion, but a substantial increase in net purchases to $4.9 billion. Moreover, we estimate that foreign trading accounted for about 14% of NYSE public trading in the 1H89, slightly below the levels of 1987-1988. Foreign ownership of U.S. equities outstanding climbed from 6.2% at the end of 1H88 to 6.6% by the 1H89.

Not to be outdone, U.S. investors entered unchartered territory. Net purchases of foreign equities at 1H89 totalled $6.1 billion, far surpassing the $292 million in net sales during the 1H88. Gross activity stood at $102 billion, over a 44% increase when compared to the 1H88 total of $70.8 billion. Further, this would put U.S. gross transactions in foreign equities at $200 billion on an annualized basis.

Leading the Way

Investors from Japan, OPEC and the U.K. alone made net purchases of U.S. equities totalling $4.5 billion in 2Q89, exceeding the net purchases of all foreign investors by $42 million. The Japanese commitment to the U.S. market, at $1.9 billion, was propelled by two main factors. First, continued political problems with the Recruit scandal and the implementation of a consumption tax kept a lid on any upward movement in Japanese equities as prices declined 1.6%. Secondly, confidence in a stable U.S. dollar, combined with a perception that lower yields on U.S. bonds (higher bond prices) would not be soon coming, made investment in U.S. equities attractive. Official data from the Ministry of Finance suggests that net activity in the third quarter will also be positive, albeit more subdued.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES BY FOREIGN INVESTORS
($Mils.)

	FIRST QUARTER 1989		*SECOND QUARTER 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q89-1Q89*
EUROPE	**$47,224**	**($154)**	**$53,375**	**$329**	**13.0%**
BELGIUM-LUXEMBOURG	2,920	(12)	3,632	(210)	24.4%
FRANCE	3,365	266	4,167	31	23.8%
GERMANY	4,082	148	4,230	(354)	3.6%
NETHERLANDS	1,753	69	1,964	(48)	12.0%
SWITZERLAND	10,410	(1,434)	11,234	(548)	7.9%
UNITED KINGDOM	22,219	767	25,196	1,112	13.4%
CANADA	**10,331**	**1,089**	**11,223**	**27**	**8.6%**
LATIN AMERICA & CARIBBEAN	**12,220**	**1,806**	**15,535**	**659**	**27.1%**
BERMUDA	2,311	485	2,797	393	21.0%
NETHERLANDS ANTILLES	4,247	999	4,643	19	9.3%
ASIA	**20,214**	**(1,299)**	**25,931**	**3,403**	**28.3%**
HONG KONG	2,174	56	2,401	(31)	10.4%
JAPAN	12,826	(1,508)	13,787	1,869	7.5%
OIL EXPORTING COUNTRIES	4,233	385	8,680	1,560	105.1%
TOTAL ALL COUNTRIES*	**$91,639**	**$389**	**$107,901**	**$4,499**	**17.5%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

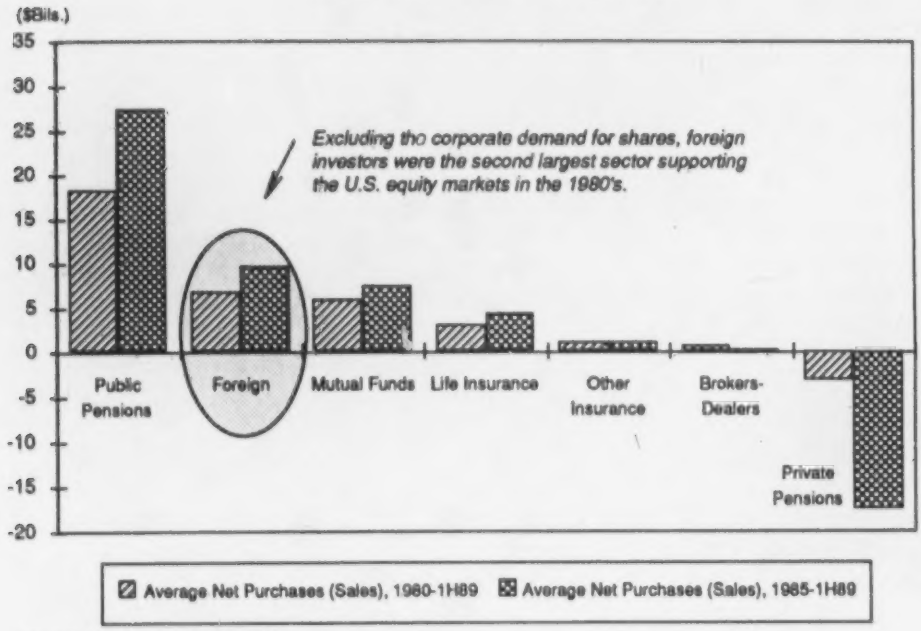
While the Japanese have returned to the U.S. equity market, it has been on sharply lower volume. Consider that their 1H89 transactions totalled $26.6 billion, down by over half from last year's 1H88 total of $60.3 billion. Reduced volume may be a sign that Japanese institutional investors are confident that the future level of the dollar will be stable and a short-term trading strategy, with profits dependent on exchange rates, not necessary.

After two years of net sales of U.S. equities totalling near $4 billion, OPEC investors made net purchases for a second consecutive quarter. Their second quarter net purchases at $1.6 billion reflects relative stability in oil prices. Their 1H89 net purchases of near $2 billion exceeded that of any country.

Interestingly, both Japan and OPEC made substantial net purchases of U.S. equities in June, $1.1 billion and $1.7 billion respectively. The turmoil in China, in June, may have been a key force behind this investment, highlighting the U.S.' reputation as a "safe haven" for investment during times of political instability.

Finally, much has been noted about foreign investment and its impact on U.S. equity prices. While it is difficult to measure the impact of foreign buying and selling on U.S. equity prices, we believe data showing the supply and demand for U.S. equities helps develop a picture by which we can, at the least, show the increasing impact these investors have on U.S. equity prices. The graph below shows the acquisition of U.S. equities (at an annual rate) through the 1980s. If we exclude the demand for shares by corporations, foreign investors rank as the second largest sector in buying U.S. equities, averaging $6.6 billion annually throughout the 1980s. Moreover, if we look at the most recent five-year period, their average acquisition rate is almost $10 billion per year. The combined effect of the foreign investors' tendency to commit funds to the larger and more liquid stocks, and the reduction of the supply of these stocks, surely magnified the impact of their net acquisitions on U.S. equity prices. Foreign investors have become relatively more important in the 1980s, at the same time many traditional investors have backed away.

Investor Demand For U.S. Equities



Source: Goldman, Sachs & Co.

U.S. Treasuries: Play me or Trade me

After snapping up $20.4 of U.S. Treasuries in the 1Q89, central bank intervention and profit taking by investors limited 2Q89 net purchases to just under $1.4 billion. This follows five quarters of substantial activity, where foreign investors averaged quarterly net purchases of $13.8 billion.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS
($Mils.)

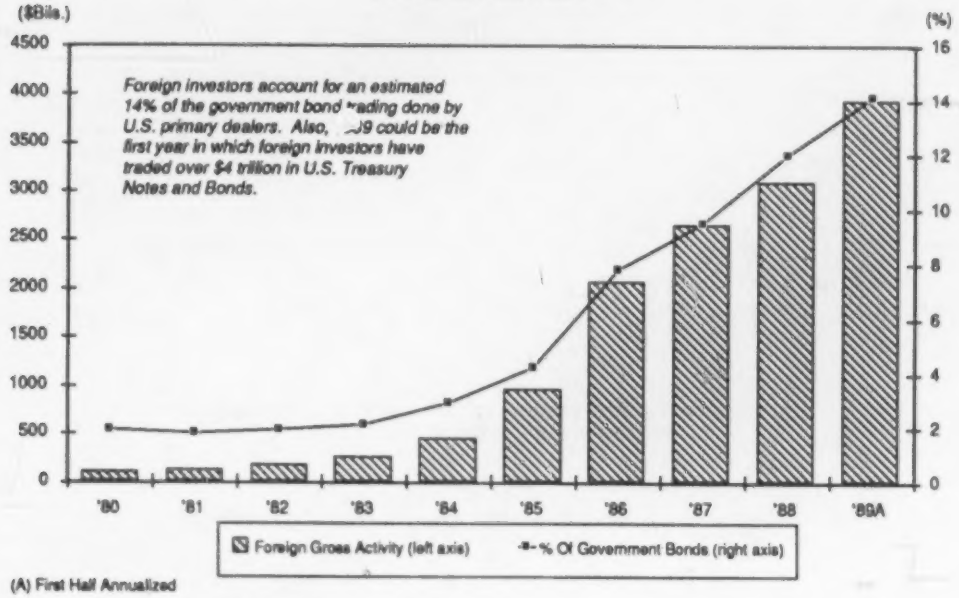
	FIRST QUARTER 1989		*SECOND QUARTER 1989*		*% CHANGE IN GA 2Q89-1Q89*
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	
EUROPE	**$368,946**	**$8,294**	**$401,901**	**$1,325**	**8.9%**
GERMANY	11,709	711	13,572	(1,978)	15.9%
SWITZERLAND	6,328	2,484	6,279	735	(0.8%)
UNITED KINGDOM	243,736	2,631	310,722	2,412	27.5%
ASIA	**423,323**	**12,205**	**605,995**	**(2,119)**	**43.2%**
JAPAN	356,737	4,467	519,354	(3,530)	45.6%
"OTHER ASIA"	26,073	6,280	34,485	(5)	32.3%
NONMONETARY INT'L & REGIONAL ORGANIZATIONS	**28,439**	**7**	**38,142**	**1,346**	**34.1%**
TOTAL ALL COUNTRIES*	**$862,473**	**$20,412**	**$1,103,511**	**$1,369**	**27.9%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

In the second quarter, with central banks shifting their concern from propping the dollar up to keeping a lid on its rise, official institutions made net sales totaling $1.3 billion. Concern about the dollar rise was particularly evident in Japan and Germany. Both countries raised the official discount rate and sold U.S. Treasuries. Net sales by Germany, totalled $2.0 billion, while Japan made net sales of $3.5 billion. In fact, the Bank of Japan experienced its first quarter-to-quarter decline in foreign exchange reserves since September 1985.

In contrast, private investors added U.S. Treasuries to their portfolios. With yields on long-term and intermediate U.S. bonds declining by 50-83 basis points during the second quarter, these investors made net purchases of $1.5 billion. However, this masks the behavior of foreign investors in June, when they were net sellers of $6.2 billion. Given the turmoil in China during this month, we find this data hard to explain, as we would have expected to see a "flight to safety." While some profit taking (U.S. governments returned 9.4% in the 1H89), and a shifting of assets to U.S. equities may have taken place during June, we believe this should not have led to substantial net sales of governments.

Foreign Activity In The U.S. Government Bond Market



(A) First Half Annualized

Source: U.S. Treasury; SIA estimates

Gross transactions in U.S. Treasury Notes and Bonds almost reached $2 trillion in the 1H89 alone. At an annualized rate, this activity will near $4 trillion in 1989 and account for over 14% of the trading in U.S. Treasuries. As an example of the tremendous growth in foreign trading of U.S. Treasuries, it is interesting to note that despite the 166% increase in foreign trading of U.S. equities during the 1980s, trading in U.S. Treasuries has increased from 53.8 % of total activity in U.S. securities to nearly 89% by the 1H89. Volatile exchange rates, the proliferation of derivative products, and the increasing amount of government debt outstanding, have contributed to the increased activity in these securities.

U.S. Activity in Overseas Equity Markets: Surprising Strength

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Mils.)

	FIRST QUARTER 1989		*SECOND QUARTER 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q89-1Q89*
EUROPE	**$24,816**	**$1,152**	**$27,561**	**$4,609**	**11.1%**
FRANCE	1,393	147	1,518	266	9.0%
GERMANY	1,428	(26)	1,528	48	7.0%
NETHERLANDS	1,091	123	1,560	402	43.0%
SWITZERLAND	1,535	161	1,836	182	19.6%
UNITED KINGDOM	17,654	586	18,653	3,333	5.7%
CANADA	**2,226**	**108**	**2,655**	**241**	**19.3%**
ASIA	**20,107**	**667**	**17,073**	**(741)**	**(15.1%)**
JAPAN	18,168	730	14,512	(864)	(20.1%)
OTHER	**3,319**	**265**	**4,290**	**316**	**29.3%**
TOTAL ALL COUNTRIES*	**$50,473**	**$1,662**	**$51,579**	**$4,425**	**2.2%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

With ample opportunity in the U.S. equity market, one may have expected the U.S. investor to stay home. And, as the table below shows, U.S. investors could have done better by staying home, if early 1989 data were the only indices examined.

EQUITY MARKET RETURNS FOR U.S. INVESTORS
(U.S.$)

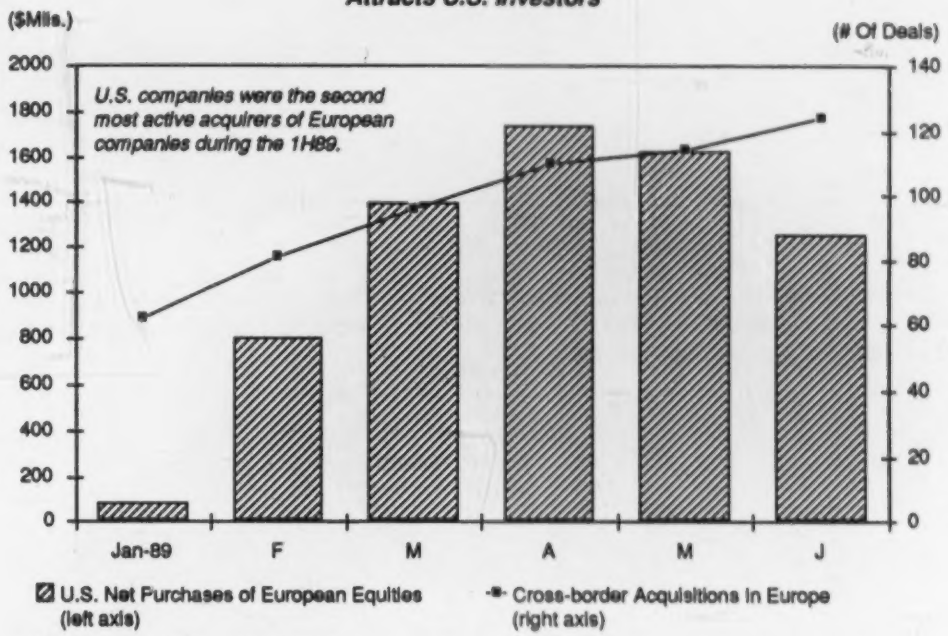
	% CHANGE 2Q89	*% CHANGE YTD*
EUROPE	**(0.2)**	2.1
FRANCE	2.9	3.2
GERMANY	7.2	0.9
NETHERLANDS	2.0	5.5
SWITZERLAND	8.1	2.6
UNITED KINGDOM	**(5.8)**	1.8
CANADA	4.3	11.6
ASIA	**(9.5)**	**(10.6)**
JAPAN	**(9.5)**	**(10.7)**
WORLD ex. U.S.	**(6.2)**	**(6.0)**
U.S.	8.0	14.6

Source: Goldman Sachs FT-Actuaries World Indices

But with a surge in European investment, U.S. investor net purchases of foreign equities totalled $4.4 billion in the second quarter. That puts 1H89 net purchases at $6.1 billion, the largest net accumulation U.S. investors have made in any time frame.

With U.K. takeover fever in high gear, U.S. net purchases of U.K. equities in the 2Q reached $3.3 billion, shattering the previous record of $1.3 billion in the 1Q87. In fact, M&A activity (on an announcement basis) in the U.K. reached a record $20.5 billion in the 2Q89. This includes a $7.7 billion bid by Smithkline for Beecham. Given that 3Q89 M&A activity was over $9 billion, some of the second quarter purchases may have been speculative in nature. However, unlike the 1Q89's 8.0% gain (U.S. $ terms), U.S. investors saw U.K. equity prices dip 5.8% as pressures from a deteriorating trade balance, high interest rates, and a slowing economy made their presence felt. More generally, we note that M&A activity in Europe was also at lofty levels in the 1H89, particularly in the U.K. and France. The graph below helps explain the extraordinary U.S. commitment to European equity markets, $5.8 billion in the 1H89.

M&A Activity in Europe Attracts U.S. Investors



Source: Financial Times; U.S. Treasury

In Japan, U.S. investors followed the lead of Japanese investors, taking profits and making net sales of $864 million. Such strategy proved wise as Japanese equities declined 9.5%, in dollar terms, during the 2Q. Further, U.S. investors in Japan have seen equity prices decline near 11% for the 1H89.

U.S. investors, after making net sales of $26 million of German equities, reversed their posture and made net purchases of $48 million. A strong U.S. dollar, coupled with GDP increasing at an annual rate of 3 1/2% during the 1H, boosted U.S. enthusiasm for German equities. In dollar terms, U.S. investors saw German equity prices gain 7.2% in the 2Q.

While not generally followed in this report, the substantial investment that U.S. investors have made in Spanish equities is interesting. First half 1989 net purchases of these equities totalled $391 million. Compared to U.S. net acquisitions of $413 million in France and $525 million in the Netherlands, U.S. interest in Spanish stocks was not minimal. If we look at U.S. activity in Spain for the year-ending

June 1989, the result is even more surprising. U.S. investors made net purchases of $640 million of Spanish equities during this period; this was only exceeded by U.S. net purchases of $5.4 billion in the U.K.

Net Purchases of European Equities By U.S. Investors
(June '88 - June '89)

Country	*Net Purchases ($Mils.)*	*% of Market Capitalization** (As at 6/31/89)
U.K.	$5,357	1.3%
Spain	640	1.2
France	557	0.4
Italy	341	0.4
Switzerland	299	0.3
W. Germany	296	0.2
Netherlands	209	0.3
Total	$7,699	0.8%

*Market capitalization figures supplied by Morgan Stanley Capital International Perspective (EAFE)

To estimate the impact of this investment, we looked at U.S. equity investment as a percent of equity market capitalization. Again, we find that the impact of U.S. investment in Europe was greatest in the U.K., with Spain not far behind. This is shown in the table above. The significant capital inflow is consistent with Spain's rapid economic expansion in the past two years. OECD data indicate GDP growth of over 5% and gross fixed capital formation of over 14%, making Spain among the fastest growing OECD countries. In addition, much interest was built in anticipation of major reforms to be made to the Spanish equity market in July of this year. We believe the "Spanish Story" has been overlooked by market observers over recent periods.

David G. Strongin
Director, International Finance

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS BY FOREIGN INVESTORS
($Mils.)

	FIRST QUARTER 1989		*SECOND QUARTER 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q89-1Q89*
EUROPE	**$13,982**	**$4,080**	**$17,345**	**$4,205**	**24.1%**
BELGIUM-LUXEMBOURG	585	(111)	545	(181)	(6.8%)
FRANCE	457	143	533	119	16.6%
GERMANY	757	217	1,139	(95)	50.5%
SWITZERLAND	820	262	1,092	(140)	33.2%
UNITED KINGDOM	10,372	3,390	12,910	3,922	24.5%
ASIA	**6,703**	**323**	**10,063**	**(967)**	**50.1%**
JAPAN	5,226	(142)	7,739	(855)	48.1%
"OTHER ASIA"	988	220	1,404	520	42.1%
TOTAL ALL COUNTRIES*	**$23,948**	**$5,594**	**$32,739**	**$4,001**	**36.7%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS

($Mils.)

	FIRST HALF 1988		*FIRST HALF 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1H88-1H89*
EUROPE	**$34,616**	**$(216)**	**$52,377**	**$5,761**	**51.3%**
FRANCE	1,758	258	2,911	413	65.6
GERMANY	2,419	(35)	2,956	22	22.2
NETHERLANDS	1,706	110	2,651	525	55.4
SWITZERLAND	2,453	565	3,371	343	37.4
UNITED KINGDOM	23,347	1,035	36,307	3,919	55.5
CANADA	**5,883**	**(111)**	**4,881**	**349**	**(17.0)**
ASIA	**25,966**	**356**	**37,180**	**(74)**	**43.2**
JAPAN	23,497	569	32,680	(134)	39.1
OTHER	**4,356**	**(321)**	**7,609**	**581**	**74.7**
TOTAL ALL COUNTRIES*	**$70,821**	**$(292)**	**$102,052**	**$6,087**	**44.1%**

Source: U.S. Treasury

* Total activity incorporates revised data; country activity does not include revisions.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS

($Mils.)

	FIRST HALF 1988		*FIRST HALF 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1H88-1H89*
EUROPE	**$596,751**	**$15,885**	**$770,847**	**$9.619**	**29.2%**
GERMANY	31.306	3.776	25.281	(1.267)	(19.2)
SWITZERLAND	11.464	262	12.607	3.219	10.0
UNITED KINGDOM	407.271	5.696	554.458	5.043	36.1
ASIA	**774,694**	**16,874**	**1,029,318**	**10,086**	**32.9**
JAPAN	663,836	15,719	876,091	937	32.0
"OTHER ASIA"	37,850	(528)	60,558	6,275	60.0
NONMONETARY INT'L & REGIONAL ORGANIZATIONS	**117,642**	**$1,090**	**66,581**	**$1,353**	**(43.4)**
TOTAL ALL COUNTRIES*	**$1,604,215**	**$38,952**	**$1,965,984**	**$21,781**	**22.6%**

Source: U.S. Treasury

* Total activity incorporates revised data: country activity does not include revisions.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES BY FOREIGN INVESTORS

($Mils.)

	FIRST HALF 1988		*FIRST HALF 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1H88-1H89*
EUROPE	**$79,799**	**$(1,545)**	**$100,599**	**$175**	**26.1%**
BELGIUM-LUXEMBOURG	4,225	227	6,552	(222)	55.1
FRANCE	6,238	(165)	7,532	297	20.7
GERMANY	5,626	203	8,312	(206)	47.7
NETHERLANDS	3,438	(480)	3,717	21	8.1
SWITZERLAND	18,087	(867)	21,644	(1,982)	19.7
UNITED KINGDOM	37,778	(736)	47,415	1,879	25.5
CANADA	**16,351**	**91**	**21,554**	**1,116**	**31.8**
LATIN AMERICA & CARIBBEAN	**18,605**	**249**	**27,755**	**2,465**	**49.2**
BERMUDA	3,472	22	5,108	878	47.1
NETHERLANDS ANTILLES	6,066	150	8,890	1,018	46.0
ASIA	**73,349**	**933**	**46,145**	**2,104**	**(37.1)**
HONG KONG	3,771	(220)	4,575	25	21.3
JAPAN	60,256	2,616	26,613	(361)	(55.8)
OIL EXPORTING COUNTRIES	6,937	(1,396)	12,913	1,945	86.1
TOTAL ALL COUNTRIES*	**$192,116**	**$(168)**	**$199,740**	**$4,888**	**4.0%**

Source: U.S. Treasury

* Total activity incorporates revised data, country activity does not incorporate revisions.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS BY FOREIGN INVESTORS

($Mils.)

	FIRST HALF 1988		*FIRST HALF 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1H88-1H89*
EUROPE	**$23,901**	**$6,079**	**$31,327**	**$8,285**	**31.1%**
BELGIUM-LUXEMBOURG	1,028	8	1,130	(292)	9.9
FRANCE	1,163	81	990	262	14.9
GERMANY	2,153	753	1,896	122	11.9
SWITZERLAND	1,995	(8)	1,912	122	(4.2)
UNITED KINGDOM	15,850	4,916	23,282	7,312	46.9
ASIA	**11,063**	**1,888**	**16,766**	**(644)**	**51.6**
JAPAN	9,323	1,921	12,965	(997)	39.1
"OTHER ASIA"	975	197	2,392	740	145.3
TOTAL ALL COUNTRIES*	**$40,273**	**$8,887**	**$56,687**	**$9,595**	**40.8%**

Source: U.S. Treasury

* Total activity incorporates revised data; country activity does not include revisions.